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Progress toward Introduction of Economic Value-Based Solvency Regulations

The following is Japan Credit Rating Agency, Ltd. (JCR)'s opinion on the "Status of Considerations for Finalization of Economic Value-Based Solvency Regulations, etc." released by the Financial Services Agency (FSA) on June 30.

(1) The introduction of economic value-based solvency regulations (new regulations) is just around the corner, and its contents are gradually becoming clearer. Mark-to-market is applied to valuation of insurance liabilities under the new regulations, which will have a significant impact on life insurers with long-term assets and liabilities in their balance sheets. However, life insurers are working to lengthen asset durations and review their liability structures to reduce the total amount of interest rate risk, and are curbing the sensitivity in economic value-based indicators, including ESR (Economic value-based Solvency Ratio). JCR considers the sufficiency of capital on an economic value basis when evaluating the capital adequacy of insurance companies, and the above perspective has already been incorporated into the ratings of life insurers in stages over the past two years or so in the review of their ratings.

(2) The introduction of new regulations is a major event that has been discussed for many years. The FSA has been holding discussions at the Expert Committee and analyzing the results of field tests with the finalization of the Insurance Capital Standard (ICS) in mind. The new regulations, which focus on the calculation of ESR, are expected to be finalized in the spring of 2024, and the calculation and reporting of regulatory capital under the new standards will begin in FY2025. Based on the "Tentative Decision of Basic Content Regarding Economic Value-Based Solvency Regulation, etc." released in 2022, the release this time provides specific details of some of the regulations, which in the tentative decision the main issues and the direction of considerations were only indicated. For example, with regard to "Supervisory Measures Based on ESR," basic directions were defined on the following: level of Prescribed Capital Requirement (PCR), recovery period in the event of a PCR violation, level of Minimum Capital Requirement (MCR), treatment of substantial net assets, and other issues. With regard to the third pillar, "Disclosure," a policy was set forth regarding disclosure deadlines for statutory disclosure items. Several points that had been unclear up to now have been clarified, but the content is being finalized in a manner that does not deviate from the assumptions JCR has incorporated into its ratings. JCR believes that the revision of the treatment of substantial net assets that are not linked to economic value-based assessments is one of the turning points toward the new regulations.

(3) In assessing the creditworthiness of insurance companies, JCR focuses on capital adequacy in the quantitative aspect. JCR considers the adequacy of capital not only in accordance with current regulations but also on the basis of economic value, and the higher the rating range, the higher the weighting of the evaluation based on economic value. The ESR figures disclosed by each company are based on internally managed risk management, and there are differences in assumptions and other factors. After the introduction of the new regulations, a certain degree of uniformity in assumptions and other factors can be achieved, which should improve comparability in terms of capital adequacy. The perspectives of reducing sensitivity of ESR through risk reduction and comparability of capital adequacy are presented in the news releases "JCR's Rating Review of Major Life Insurers" (22-D-1315) and "Trends in Economic Value-Based Solvency Regulations and Others" (23-D-0239).

(4) Although the new regulations are expected to be more complex and impose heavier administrative burdens than the current regulations, JCR believes that each company will be able to fully comply with the new regulations and make a smooth transition. In addition, restructuring of the qualifying capital structure in conjunction with introduction of the new regulations will mean that the currently somewhat divergent evaluations of regulatory capital and rating capital will converge under an economic value-based approach. JCR will continue to monitor the progress of the finalization of the new regulations, including the finalization of the ICS, and will also continue to confirm the status of systems and information disclosure of individual companies, as well as their adjustments with the approach of capital based on internal management.

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